

FX Daily: Time to buy back the dollar?

We are inclined to think that the dollar decline does not have legs and markets may use the current levels - especially against low-yielders - to build back some dollar longs ahead of tomorrow's US CPI and next week's Fed meeting. GBP may struggle to recover just yet after new restrictions in the UK, NOK gains may pause but resume next week



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USD: Attractive levels to build back dollar longs

The news that Pfizer expects three vaccine doses to provide good enough coverage against the Omicron variant was not received uniformly by asset classes. Treasuries weakened and 10-year yields broke above 1.50%, but equities struggled to stay in the green and commodities staged only a contained rally. In FX, the dollar emerged as an underperformer, seemingly re-establishing a negative correlation with risk appetite. We think the yuan's very good momentum was key in generating a dollar-negative market mood yesterday by carrying China-sensitive currencies higher even before the Pfizer announcement.

Some position-squaring also appears to be behind the dollar moves, and it is no surprise to see the Australian dollar, [the G10 biggest short](#), recover ground more rapidly than its closest peer, the New Zealand dollar (which is, instead, already in net-long territory). In the rest of the pro-cyclical space, Norway's krone is the big standout after a 1.5% rally in yesterday's session (more details in a

section below) while Canada's dollar was held back by a Bank of Canada meeting yesterday that apparently disappointed some unduly hawkish expectations considering the Omicron uncertainty, but [still paved the way for four rate hikes in 2022, in our view.](#)

It is also to note that the Fed's rate expectations have moved higher since the emergence of the Omicron variant (thanks to Fed Chair Jerome Powell's dovish comments) and the news that vaccines may offer good coverage may be encouraging some catch-up in other currencies/rate expectations that had instead seen a dovish re-pricing.

There are only jobless claims data on the US calendar today, and the dollar should remain driven by global factors. We are inclined to think that investors may be attracted by current levels (in particular against low-yielders) to build back some dollar longs ahead of the CPI report tomorrow and the Fed meeting next week, so we would expect the dollar to start finding some support as early as today.

⬇️ EUR: 1.1380 is the level to watch

The EUR/USD rally stalled around the 1.1350 level yesterday, now trading in the middle of the 1.1300/1.1350 range. Rather than a break above 1.1350, we see more significance in the 1.1380 resistance which was where the 30 November rally found a stop. A break above that level may signal consolidating bullish sentiment, and possibly rising bets on a hawkish turn by the European Central Bank next Thursday. We are more inclined to expect a pullback towards the 1.12/1.13 range in the next few days, as markets may see some attractive levels to enter long-USD positions ahead of the Fed meeting next week.

Elsewhere, the focus today will be on what the National Bank of Hungary (NBH) does with its one week deposit rate, currently at 3.10%. This follows Wednesday's release of November inflation at 7.4%, the highest since December 2007. The forint performed well on Wednesday, perhaps as a popular cross trade PLN/HUF came lower after the National Bank of Poland ['only' hiked rates by 50bp](#). We look for another 20bp hike in the one week HUF deposit rate today, which should keep the forint supported into next week's formal NBH policy meeting.

⬇️ GBP: Hit by new restrictions

Sterling is currently the big underperformer in the G10 space, dragged down by the introduction of new Covid restrictions by the British government yesterday. New guidance to work from home is largely expected to generate a fresh drag to an economy that can no longer count on pandemic emergency support tools, like the furlough scheme. This is likely contributing to tilt market sentiment further towards the "no-hike" camp ahead of the 16 December Bank of England meeting. There are currently 6bp of the 15bp of tightening priced in for next week.

PM Boris Johnson seems to be navigating the toughest period of his tenure and there is some risk that along with the economic implications of new restrictions in the UK, markets may be inclined to price in some degree of political instability as well. On the flipside, the news that a booster dose of Covid vaccines may allow good protection against Omicron is probably good news for a country like the UK which has been quite fast in rolling out new doses, especially to the most at-risk categories.

Some recovery in the dollar may pressure cable below 1.3200 today, with sterling struggling to show any idiosyncratic strength for the time being.

➔ NOK: Gains could pause today, but resume next week

Norway's krone extended early-week gains yesterday, with EUR/NOK breaking below the 10.10 level and now trading around 10.06. The improvement in Omicron-related sentiment is indeed the main driver of the krone's exceptional performance, as the currency was one of the worst hit from the initial risk-off shock given its low liquidity and high-beta to risk and oil. Another spike in natural gas prices - caused by a Norwegian plant outage - also pushed NOK higher.

Additionally, we are seeing a recovery in the market's expectations around Norges Bank tightening in 2022, which experienced a larger dovish repricing (after the Omicron news broke) than most of its peers given the rapidly worsening outlook for energy prices. Markets may have started to position for a hawkish tone by the Norges Bank as it announces monetary policy (and most likely hike rates) next week.

We may see some pullback after yesterday's big move, but there is likely some more room for NOK to appreciate into the NB meeting next week.

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